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SUBJECT: PART TWO OF FOUR: RESULTS OF FINANCIAL SYSTEMS
ASSESSMENT TEAM VISIT TO YEMEN MAR 1-7, 2007

REF: SANAA 1418

¶1. Summary. A multi-agency Financial Systems Assessment Team (FSAT) conducted a week-long, in-country evaluation of Yemen's capacity to combat money laundering and terrorist financing, in order to determine its most critical training and technical assistance needs on March 1-7, 2007. This second section of the FSAT Team's report focuses on the ROYG's Anti-Money Laundering Information Unit, the development of Yemen's financial sector, and the Central Bank of Yemen. End summary

ANTI-MONEY LAUNDERING INFORMATION UNIT

¶2. Law No. 35/2003 created the Anti-Money Laundering Information Unit (AMLIU) as Yemen's financial intelligence unit (FIU). The AMLIU consists of three members: a chairman, a legal expert and a technical expert for verifications.

¶3. The AMLIU is housed within the Central Bank of Yemen (CBY), and provides the CBY with both financial and administrative support, including legal and regulatory personnel. However, the AMLIU claims that it is technically independent from the Central Bank since it is not required to report to the CBY. According to its organizational structure, the AMLIU can share information with, but does not necessarily report to, the following three entities: the Central Bank Governor, the National Anti-Money Laundering Committee (NAMLC), and the Deputy Governor for Banks.

¶4. The AMLIU receives suspicious transaction reports (STRs) from banks, money exchangers, insurance companies, stocks and bonds companies, and financial real estate leasing companies. STRs are delivered to the AMLIU by a courier, with an authorized signature required upon receipt. There is no specified time limit for filing STRs to the AMLIU.

¶5. The AMLIU received two STRs from financial institutions in 2005, and three STRs in 2006. In 2007, the AMLIU has so far forwarded one suspicious case to the Office of Public Prosecution for suspected money laundering. Once the AMLIU receives the STR, it reviews all the information and supporting documentation contained within the report. If there are any missing data from the STR or supporting documents, the AMLIU may request additional information directly from the bank or conduct an onsite visit. The AMLIU then determines whether the case is of a criminal nature.

The AMLIU forwards criminal cases to the Office of Public Prosecution for further investigation. The AMLIU itself does not have an investigative capacity. The AMLIU has one member with investigative experience, but needs additional capacity-building training.

¶6. The AMLIU is divided into three separate divisions: investigations, analysis and legal monitoring, and information technology. The investigations division serves more as a verification function, rather than an investigative function, and conducts field visits to financial institutions. The analysis and legal monitoring division receives and analyzes the STRs, and reports those cases to the Office of Public Prosecution. The information technology division collects and compiles all data received into an electronic database, and shares information with other government agencies.

¶7. The AMLIU faces several challenges with its efforts to combat money laundering and terrorist financing. The general lack of AML/CTF awareness, as well as formal training in AML/CTF detection, are its foremost challenges, for which the AMLIU has requested immediate assistance. Other challenges that impede the AMLIU's efforts include: (1) the corruption and embezzlement of public funds, which they claim are rampant throughout the country; and (2) terrorist acts conducted by highly skilled terrorist groups. Another challenge to the effectiveness of Yemen's AML/CTF regime is the high degree of cash being circulated in the informal banking sector (approximately 60-80% of total funds).

¶8. The AMLIU is in need of fundamental training and technical assistance in the following areas: (1) detecting suspicious activity in financial transactions; (2) analyzing suspicious transaction reports once they are received; and

(3) creating an electronic database of all STRs and related information within the AMLIU in order to conduct future link analysis. As a first step, an analytic exchange with FinCEN is recommended in the near future in order to provide the Yemenis with a better understanding of a fully functional AMLIU, as well as a general overview of AMLIU operations in each of these specified areas.

DEVELOPMENT OF THE FINANCIAL SECTOR

¶9. Yemen's financial sector is rudimentary as Yemen is predominantly a cash-based society. Officials insist that the financial sector is not conducive to money laundering due to the poor economic factors and the limited capital of Yemeni banks. However, officials also reported a 35% growth rate in domestic bank deposits in 2006 compared to a 28.5% growth rate by Arab and foreign banks operating in country. Also, reports indicate that Yemen banks' revenues were 360 billion Yemeni Riyals (USD 1.8 billion) in 2006; and deposits reached 214 Yemeni Riyals (USD 1.1 billion), with capital of 854 Yemeni Riyals (USD 4.3 billion) by year-end 2006.

¶10. Officials indicated that several initiatives have been planned in order to attract more of the population into the formal financial system: deposit insurance on accounts; direct deposit of ROYG payroll into bank accounts; expansion of the ATM network; and the offering of Treasury Bills. On 03/06/2007, members of the team accepted an invitation from the Chairman of the Cooperative & Agricultural Credit Bank (CAC Bank) to view its state-of-the-art Visa Card operations facility at the main branch in Sana'a. The bank's initiative to expand services to the non-banking community and promote trust and reliance in electronic payments systems indicates a degree of financial sophistication and progress. All of these trends indicate increased penetration by the financial sector into the cash economy as the banks and others begin to pursue the non-bank market. It is therefore critical that anti-money laundering regulations and controls be implemented at a similar pace to avoid the risk of an unregulated sector.

Regulatory Framework

¶11. The current AML law established a number of institutions such as the AMLIU and the National AML Committee, and listed various money laundering offenses, which do not include terrorist financing or tax evasion. The AML law levies a number of regulatory and other requirements on financial institutions (i.e. banks; money exchanges; and companies - funding, insurance, securities, financial leasing, and real estate) although the CBY's supervision is limited to banks and money exchanges. Financial institutions are required to develop formal procedures that address the following:

- A formal compliance program that includes training, testing for compliance, and the designation of an experienced individual responsible for ensuring compliance (i.e., the Compliance Officer).

- Customer identification. Financial institutions are required to record, verify, and retain customer identification/basic information in order to determine the true beneficiary. The required form of identification to open a bank account and apply for other social benefits is the National Identification Card. It contains a person's photograph and fingerprint, and reportedly is difficult to duplicate. Accounts include deposit/transaction accounts, loan and credit accounts, and safe deposit boxes. Customers include individuals, legal persons, public companies, and non-profit organizations (e.g., NGOs).

- Prohibitions on opening anonymous accounts and foreign correspondence accounts for any person prior to ratification of the signature from the correspondent bank in the country at which said person resides.

- Payable upon proper identification (PUPID). Non-customers or PUPIDs initiating or receiving funds transfers exceeding USD 10,000 or its equivalent in any other currency are required to provide proper identification, address, occupation, and information on the true beneficiary.

- Retention of certain financial records for five years.

CENTRAL BANK OF YEMEN (CBY)

¶12. The CBY was established in 1971 and merged with the Bank of Yemen when the north and south united in 1990. Its main functions include monetary policy; currency issues; management of the official reserves; serving as the bankers, bank and bank to the ROYG; and supervision of the banking system. It supervises 17 commercial banks in the country, four of which are Islamic. Staffing includes 20 examiners. In addition, the CBY has authority over the 448 money exchanges that reportedly consist of 20 major exchanges. However, the supervision of money exchanges is limited to off-site reviews of financial and compliance records provided by the money exchanges to the CBY. Typically, CBY examiner on-site reviews are limited to banks.

¶13. The banks are examined at least once annually and reports are issued after each examination. Technically, the CBY has the authority to implement enforcement action, but in practice, it provides training to improve inadequacies noted. CBY admitted that banks/money exchanges still need time to implement compliance requirements. A meeting with a group of private bankers indicated that compliance with the AML laws has been a slow process. Compliance programs have been developed and implemented one at a time such as the "Know Your Customer" programs, which are designed to ensure customer identification and basic information is recorded, verified and retained. The bankers admitted that developing effective suspicious activity programs and procedures has been difficult as more training is needed to better understand the concept of suspicious activity. In addition,

the bankers indicated that the Bankers Association has done little to assist with AML compliance issues to date.

¶14. The formal examination procedures used to test the bank,s compliance with the AML laws are too limited to be effective. The procedures consist of approximately 12 questions relating to the existence of a compliance program, compliance officers, training programs, and reports of cash transactions over USD 10,000. The procedures are not comprehensive and do not provide for an assessment of the aforementioned elements and transaction testing to quantify the level of compliance.

UNSCR 1267 Compliance

¶15. In response to UNSCR 1267 in September 2003 and the Yemen,s Council of Ministers, directives, the CBY has issued a number of circulars (most notably 75304 and 75305) to all banks operating in Yemen, directing them to freeze the accounts of 144 persons, companies and organizations on the 1267 consolidated list, and to report any findings to the CBY. The CBY has issued updated circulars to banks after updated 1267 information is passed from the Yemeni Embassy in Washington or Consulate in New York through the Ministry of Foreign Affairs and is voted on by the Cabinet. However, it takes approximately one month for the list to be distributed by the Yemeni Embassy in Washington, D.C., reviewed by various ministries in Yemen, and received by the CBY. The CBY hand delivers the list to its financial institutions. To date, only one report on a blocked account has been filed, which was hand delivered by the bank to the CBY. In addition, Yemen has yet to take any action against or freeze the assets of Sheikh Abdul Majid Zindani, despite his February 2004 addition to the 1267 list.

CBY,S CHALLENGES AND VULNERABILITIES

¶16. The primary challenge affecting the CBY,s ability to ensure compliance with AML laws is the lack of adequate technical training. The CBY indicated that it provides bank and money exchange training in an attempt to improve compliance and in lieu of implementing enforcement action for non-compliance. However, it is alarming that the individuals providing the training are not adequately trained and do not appear to have sufficient expertise to conduct the training. In addition, the current AML laws are not comprehensive, and the implementation of existing AML laws and minimum

international standards on AML/CTF (i.e., FATF recommendations and UNSC resolutions) are ineffective. Banks are still in the process of implementing and understanding AML issues. The CBY lacks proven enforcement authority, and the level of non-compliance with AML laws has not been quantified.

¶17. The financial sector appears vulnerable to exposure to ML/TF schemes from certain persons and entities of heightened risk and through the use of certain products/services, specifically funds transfers. There are no requirements to declare currency and its equivalent at border crossings or to report large currency transactions, and no safe-harbor provision exists relative to the filing of STRs.

¶18. The CBY indicated it is vulnerable to corruption and terrorism. The embezzlement of public funds is rampant, and terrorist groups have a myriad of ways to smuggle funds across the country,s porous land and sea borders. Enforcement of the AML laws is questionable based on the level of corruption.

¶19. Other identified weaknesses include the following:

¶20. The AML laws are not comprehensive and do not address international minimum standards. For example, the AML laws do not incorporate the following:

- a) All provisions of Recommendation 5 from the Financial Action Task Force on Money Laundering's List of Recommendations, specifically conducting on-going due diligence on business account relationships and scrutiny of transactions to ensure that the transactions are consistent with the customer's known risk profile.
- b) Recommendation 6 relating to Politically Exposed Persons (PEPs).
- c) Recommendation 7 relating to correspondent bank relationships.
- d) Recommendation 14 relating to confidentiality of STRs. Although the AML laws address the recommendation, in practice the STR form allows for the subject's signature in contravention of the AML laws.
- e) Recommendation 15 relating to compliance programs to combat terrorist financing.
- f) Recommendation 18 relating to the prohibition of shell banks.

¶21. There are no CTF laws. According to the Committee, a law has been drafted and needs to be vetted by several ministries before it is presented to Parliament. The Committee recognizes the proposed CTF law will not be approved before the mutual evaluation in July 2007, and indicated it would not likely be approved for another six months after that. Although there is some indication that Yemen has provided for international cooperation and review of non-profit organizations to some degree, the FATF Special Recommendations on Terrorist Financing have not been implemented. In addition, UNSCRs 1267 and 1373 are not addressed in statute, although the CBY did issue a circular relative to UNSC resolution 1267. However, the procedure in place does not appear to satisfy the "freeze without delay" provisions, due to delays in notification. Abdo Hezam Saif, Head of the Central Bank's AMLIU, told AMEMB Yemen on July 22, 2007 that a joint technical committee (which was formed from the National Anti-Money Laundering Committee and the Central Bank's AMLIU) completed the draft CTF law, is making minor amendments to it, and will forward it to the Cabinet by mid-August 2007, which will later forward it to Parliament when Parliament reconvenes in mid-October 2007 at the earliest.

¶22. The training provided has not been effective. Two CBY members attended the International AML/CTF Training in Arlington, VA in September 2006. Conversations with the CBY confirmed that these individuals did not subsequently train other CBY personnel and the banking and money exchange communities. However, CBY indicated that at least one of the individuals will serve as a training instructor at the Yemen Bankers Association. One of the individuals works in the AMLIU and the other works in Supervision. CBY indicated that the individuals were overwhelmed by the scope and complexity of the training course, and also expressed difficulty in comprehending the materials in English.

¶23. Money exchanges are largely unregulated. Although they are required to be licensed by the CBY, the level of

supervision is nominal. The money exchanges are not subject to the same examination process as banks.

¶24. There are no reporting requirements for currency transactions, currency exchanges, monetary instruments, and funds transfers that are conducted by customers of the financial institutions.

¶25. Suspicious activity and reporting thresholds are not defined.

¶26. The number of STRs filed is not commensurate with the perceived AML risks. Since the inception of the AML laws, the financial institutions have filed only six STRs: two in 2005; three in 2006; and one year-to-date. Although the latter STR is in the process of review, the other STRs were not referred to the Public Prosecutor and none were filed by the money exchanges.

¶27. Customer due diligence is limited to identification procedures. There are no requirements to record and understand the customer,s source of funds and expected transactions, which would enable the financial institution to detect patterns and trends of suspicious activity.

¶28. Potentially high-risk persons/entities and products/services are not addressed. The identification, enhanced due diligence, and on-going monitoring of certain customers (e.g., Politically Exposed Persons, Professional Service Providers, cash-intensive businesses) and products/services (e.g., private banking accounts, funds transfers) would better enable the financial institutions to detect patterns and trends of suspicious activity.

RECOMMENDED TRAINING AND TECHNICAL ASSISTANCE

Training

¶29. Basic AML/CTF training is required. Training should be provided to CBY examiners, AMLIU employees, and perhaps to representatives of the National AML Committee and Yemen Bankers Association. The training should be disseminated to the financial community to ensure they are aware of AML/CTF efforts and best practices.

¶30. CBY indicated its two primary training needs relate to cyber crimes and terrorist financing detection and techniques used by groups. The Committee indicated its two primary training needs relate to investigating and tracking funds and AMLIU systems development.

¶31. The content of the STRs was discussed with the CBY in a follow-up meeting held on 03/06/2007. AMEMB Yemen provided the CBY with a copy of FinCEN,s Suspicious Activity Report form and instructions in an attempt to assist in developing a new enhanced STR form. In addition, a copy of the Federal Financial Institutions Examination Council,s Bank Secrecy Act/AML Examination Manual was provided to illustrate the extent to which examination procedures should be developed and implemented.

¶32. An offer should be extended to review the CBY,s AML/CTF examination compliance program (i.e., procedures and workpapers) to ensure it is comprehensive and effectively implemented through analyses, assessments, transaction testing, and sampling techniques.

¶33. The AML Committee was interested in having the newly drafted AML/CTF decree reviewed before it is presented to Parliament. Upon translation and study, the USG should provide comments with respect to how well the legislation comports with international standards, as well as recommendations to bring legislation into compliance with international standards.

BRYAN